

**DEPARTMENT OF TRANSPORTATION****AUDITS AND INVESTIGATIONS**

1304 O STREET, SUITE 200

P.O. BOX 942874 – MS 2

SACRAMENTO, CA 94274-0001

PHONE (916) 323-7111

FAX (916) 323-7123

TTY 711

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May 7, 2009

Mr. Ted Smalley  
Deputy Executive Director  
Tulare County Association of Governments  
5961 S. Mooney Blvd.  
Visalia, CA 93277

Re: Tulare County Association of Governments  
Audit of Indirect Cost Allocation Plan for FY 2007/2008  
File number: P1190-0641

Dear Mr. Smalley:

We have audited the Tulare County Association of Government's (TCAG) Indirect Cost Allocation Plan (ICAP) for the fiscal year (FY) ended June 30, 2008, to determine whether the ICAP is presented in accordance with 2 Code of Federal Regulations (CFR) Part 225 (formerly Office of Management and Budget Circular A-87) and the California Department of Transportation's (Department) Local Programs Procedures (LPP) 04-10. TCAG management is responsible for the fair presentation of the ICAP. TCAG proposed an indirect cost rate of 49.70 percent of total direct salaries and wages plus fringe benefits.

Our audit was conducted in accordance with the Standards for Performance Audits set forth in the *Government Auditing Standards* issued by the Comptroller General of the United States of America. The audit was less in scope than an audit performed for the purpose of expressing an opinion on the financial statements of TCAG. Therefore, we did not audit and are not expressing an opinion on TCAG's financial statements.

The standards require that we plan and perform the audit to obtain reasonable assurance about whether the data and records reviewed are free of material misstatement, as well as material non-compliance with fiscal provisions relative to the ICAP. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and records reviewed. An audit also includes assessing the accounting principles used and significant estimates made by TCAG, as well as evaluating the overall presentation.

The accompanying ICAP was prepared on a basis of accounting practices prescribed in 2 CFR Part 225 and the Department's LPP 04-10, and is not intended to present the results of operations of TCAG in conformity with generally accepted accounting principles.

The scope of the audit was limited to select financial and compliance activities. The audit consisted of a recalculation of the ICAP, a limited review of the Overall Work Program (OWP) for FY 07/08, inquiries of TCAG personnel, and reliance placed on the single audit report for the FY ended June 30, 2006. The audit also included tests of individual accounts to the general ledger and supporting documentation to assess allowability, allocability and reasonableness of costs based on a risk assessment and an assessment of the internal control system as related to the ICAP as of August 22, 2007. Financial management system changes subsequent to this date were not tested and, accordingly, our conclusion does not pertain to changes arising after this date. We believe that our audit provides a reasonable basis for our conclusion.

Because of inherent limitations in any financial management system, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the financial management system to future periods are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Our findings and recommendations take into consideration TCAG's response dated March 19, 2009, to our March 5, 2008, draft findings. Our findings and recommendations, a summary of TCAG's response and our analysis of the response are detailed below. See Attachment I for a copy of TCAG's response.

## **AUDIT RESULTS**

Based on audit work performed, TCAG's ICAP for the FY ended June 30, 2008, is presented in accordance with 2 CFR Part 225 and LPP 04-10. The approved indirect cost rate is 49.70 percent of total direct salaries and wages, plus fringe benefits. The approval is based on the understanding that a carry-forward provision applies and no adjustment will be made to previously approved rates.

TCAG requested a provisional rate of 47.25 percent for FY 07/08. Audits and Investigations approved the provisional rate on March 28, 2008.

## **Audit Findings**

### **Finding 1**

Through our testing of costs in work element 601.02, we found that in its second-quarter billing for FY 06/07, TCAG billed the Department and was reimbursed \$81,864 for indirect costs. The \$81,864 in costs was for the allocation of countywide cost allocation plan, IT copier, administration labor, workers compensation and internal services. Further, the indirect costs were aggregated with direct costs so that they were not separately identified in the billing. During our review of the OWP work elements and discussion with TCAG staff, we discovered that TCAG accounts for indirect administrative activities by assigning the related costs to work element 601.02 and accounting code 601.022. A similar situation occurred with the fourth-quarter billing as detailed below in Finding 2.

LPP 04-10, Section 5.2 Page 5-4 states in part, that local agencies must receive approval for its indirect cost rate prior to billing for indirect costs. Additionally, indirect costs must not be combined with direct costs on invoices.

#### **Recommendation**

TCAG should refrain from billing the Department for indirect costs until it receives an approved indirect cost rate for each FY for which it requests reimbursement of indirect costs. Additionally, TCAG should identify indirect costs separately from direct costs on its invoices. We further recommend that TCAG discontinue the use of indirect work elements and instead allocate and bill for indirect costs through the use of an approved indirect cost rate.

#### **TCAG's Response**

See Attachment I for detailed response.

#### **Analysis of Response**

TCAG agreed with the finding. The finding and recommendation remain.

#### **Finding 2**

In its fourth-quarter billing of FY 06/07, TCAG inappropriately reassigned \$53,000 of indirect labor and other administrative costs to four direct work elements. TCAG staff stated that there were too many labor hours charged under work element 601.02, so the labor and administrative costs were charged to direct work elements 601.06, 602.01, 604.02 and 670.05. The reason these particular work elements were chosen to bear the additional cost is unclear. We also noted that \$1,735 recorded in the accounting system under work element 601.05 was billed under work element 605.01. Because of the reassignment of costs, the amounts billed and reimbursed under the direct work elements are not fully supported by accounting records. It appears a similar reassignment of costs also occurred in the second-quarter billing as of FY 06/07 where \$19,678 and \$1,723 of costs recorded in work elements 670.09 and 601.07, respectively, were reported under work element 602.05.

49 CFR Part 18.20 (b) (1) states in part, that financial management systems provide for the accurate, current and complete disclosure of the financial results of financially assisted activities. 49 CFR Part 18.20 (b ) & (6) require in part, that grantees and subgrantees maintain records which adequately identify the source and application of funds, and that they are supported by such source documentation as time and attendance records.

2 CFR Part 225 Appendix B, (8) (h) (4) states in part, that for employees working on an indirect and direct activity, a distribution of their salaries and wages will be supported by personnel activity reports that meet the standards of subsection (8) (h) (5), which includes, but is not limited to, an after-the-fact distribution of actual activity.

#### **Recommendation**

We recommend TCAG establish procedures to ensure that the reports from their accounting and job costing systems support the amounts billed. Additionally, TCAG should review each

billing submitted during FY 07/08 to identify any indirect costs billed directly. The indirect costs should be removed from the directly billed work elements. In order to recover the indirect costs, the approved indirect cost rate should be applied only to the direct salary and wages allocable to the direct work elements. TCAG should then re-invoice the Department and repay any over-recovered costs.

**TCAG's Response**

See Attachment I for detailed response.

**Analysis of Response**

TCAG agreed with the finding. Finding and recommendation remain.

**Finding 3**

TCAG currently maintains a manual system of accounting for project costs. The process of retrieving and aggregating the costs from the TCAG accounting system is a manual endeavor, relying heavily on copy-and-paste of screen shots from the AFIN accounting system, into an Excel spreadsheet. The data is then manually summed in Excel by work element number and transferred onto the bill. The use of a manual process to determine project costs and billing increases the risk of errors and requires reconciliation between the manual and automated processes. 49 CFR Part 18.20 (b) (3) requires effective control and accountability be maintained for all grant and subgrant cash, real and personal property and other assets.

**Recommendation**

TCAG should explore the feasibility of implementing an automated system. TCAG staff mentioned that Tulare County installed a Windows-based AFIN system that could generate reports. TCAG should investigate this new system to see if it has the capability to accurately assemble costs in a workable format, which could be used for billing.

**TCAG's Response**

See Attachment I for detailed response.

**Analysis of Response**

Finding and recommendation remain.

**Finding 4**

TCAG included direct costs from twelve OWP work elements in the indirect cost pool. Our review found the direct costs should be excluded from the indirect cost pool as they can be directly charged through the OWP work elements to federal and local governments. 2 CFR Part 225, Appendix A, Section E, (1) defines direct costs are those that can be identified specifically with a particular final cost objective. Appendix E, Section A, states in part, that indirect costs as those incurred for a common or joint purpose, and that after direct costs have been determined and assigned directly to federal awards and other activities as appropriate, indirect costs are those remaining to be allocated. Indirect costs are normally charged to federal awards by the use of an indirect cost rate. Including direct project costs in

the indirect cost pool does not provide consistent treatment of costs and will improperly inflate the indirect cost rate. The final approved rate excludes these direct costs.

#### **Recommendation**

We recommend in the future TCAG exclude direct cost work elements from the indirect cost pool.

#### **TCAG's Response**

TCAG believes that those issues have been resolved with better guidance from Audits and Investigations and continuous work on the FY 08/09 ICAP and FY 09/10 ICAP.

#### **Analysis of Response**

TCAG agreed with the finding. Finding and recommendation remain.

#### **Finding 5**

TCAG's OWP work elements 601.02, 601.04 and 601.07, while presented as direct costs, include activities that are administrative and indirect in nature. Specifically, general administration, office expenses, and travel and training should be treated as indirect costs. Directly charging administrative and indirect activities to a federally funded work element will result in the federal government paying a disproportionate share of indirect costs. 2 CFR Part 225, Appendix E, Section A states in part, that indirect costs are those costs incurred for a common or joint purpose, and that after direct costs have been determined and assigned directly to federal awards and other activities as appropriate, indirect costs are those remaining to be allocated. In addition, these work elements included unallowable costs which are detailed in finding 6.

#### **Recommendation**

We recommend TCAG revise future OWPs to ensure indirect and unallowable activities are segregated from allowable direct activities. We also recommend that indirect costs already charged directly for FY 07/08 for work elements 601.02, 601.04, and 601.07 be reimbursed to the Department or credited on the next reimbursement request.

#### **TCAG's Response**

TCAG has removed all three of those work elements from its OWP and expenses for those work elements are now being recovered under TCAG's indirect cost rate.

#### **Analysis of Response**

TCAG agreed with the finding. Finding and recommendation remain.

#### **Finding 6**

TCAG included unallowable costs in its initial and subsequent FY 07/08 ICAP submittals. Specifically,

- TCAG included \$24,994 of Tulare County Resource Management Agency (RMA) indirect costs in TCAG's indirect cost pool. RMA does not have an approved indirect cost rate, or support for an indirect cost allowance, therefore TCAG should exclude

RMA's indirect costs from the indirect cost pool. 2 CFR Part 225 Appendix A, Section G states "the cost of services provided by one agency to another within the governmental unit may include allowable direct costs of the service plus a pro rata share of indirect costs. A standard indirect cost allowance equal to ten percent of the direct salary and wage cost of providing the service (excluding overtime, shift premiums and fringe benefits) may be used in lieu of determining the actual indirect cost of the service."

- TCAG included a \$15,000 contingency for general association activities that are fully paid for by member dues. 2 CFR Part 225, Appendix B, (9) states in part, that contributions to a contingency reserve or similar provision are unallowable.
- TCAG included \$55,000 in budgeted capital expenditures costing over \$5,000 in the indirect cost pool. 2 CFR Part 225 Appendix B, (15) (b) (5) states in part, that equipment is unallowable as an indirect cost. A&I advised TCAG staff that equipment costs may be recovered by including depreciation or use allowances in the indirect cost pool, but TCAG declined this option.
- TCAG included travel costs associated with unallowable lobbying activities in work element 601.07. TCAG budgeted travel costs for CALCOG meetings, Statewide COG directors, Valleywide COG directors, TCAG delegation to Sacramento and Washington and NARC workshops, which involve lobbying activities. Lobbying is unallowable per 2 CFR Part 225 Appendix B (24).
- TCAG included Transportation Development Act (TDA) audit costs that are directly reimbursed by TDA. 2 CFR Part 225, Appendix A, Section E, (1) states that direct costs are those that can be identified specifically with a final cost objective.

Including unallowable costs in work elements or in the indirect cost pool will improperly inflate the direct and indirect costs and may result in over-recovery of costs.

#### **Recommendation**

TCAG should establish procedures to ensure that unallowable costs are segregated from other allowable direct and indirect costs and are excluded from indirect cost pool and direct costs in future ICAP submittals.

#### **TCAG's Response**

TCAG understands the issue and removed from the direct work element costs from the indirect cost pool.

#### **Analysis of Response**

TCAG agreed with the finding. Finding and recommendation remain

This report is intended solely for the information of TCAG, Department Management, the California Transportation Commission, and the Federal Highway Administration (FHWA). However, this report is a matter of public record and its distribution is not limited.

Mr. Ted Smalley  
May 7, 2009  
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Please retain the approved ICAP for your files. Copies were sent to the Department's District 6, the Department's Division of Accounting, and FHWA. If you have any questions, please contact Amada Maenpaa, Audit Manager, at (916) 323-7868.

  
MARYANN CAMPBELL-SMITH  
Chief, External Audits

Attachments

- c: Brenda Bryant, Director, Financial Services, Federal Highway Administration
- Sue Kiser, Director, Planning and Air Quality, Federal Highway Administration
- Dan Mundy, Branch Chief, Rural Transit and Procurement, Division of Mass Transportation
- David Saia, Senior Transportation Engineer, Policy Development and Quality Assurance, Division of Local Assistance
- Jenny Tran, Associate Accounting Analyst, Local Assistance Accounting Branch, Division of Accounting
- Andrew Knapp, Associate Transportation Planner, Regional and Interagency Planning, Division of Transportation Planning
- Paul-Albert Marquez, Chief, Central Planning, District 6
- Jim Perrault, Local Assistance Engineer, District 6
- P1190-0641



5961 S. Mooney Blvd.  
Visalia, California 93277  
(559)733-6291  
FAX (559)733-6720

## Tulare County Association of Governments

### *Indirect Cost Plan*

The indirect cost rate contained herein is for use on grants, contracts and other agreements with the Federal Government and California Department of Transportation (Department), subject to the conditions in Section II. This plan was prepared by the Tulare County Association of Governments staff and approved by Caltrans.

#### **SECTION 1: Rates**

<u>Rate Type</u>	<u>Effective Period</u>	<u>Rate*</u>	<u>Applicable To</u>
(First Year) Fixed Rate	7/01/07 to 6/30/08	49.70%	All Programs

\* Base: Total Direct Salaries and Wages plus fringe benefits

#### **SECTION II: General Provisions**

##### **A. Limitations:**

The rates in this Agreement are subject to any statutory or administrative limitations and apply to a given grant, tract, or other agreement only to the extent that funds are available. Acceptance of the rates is subject to the following conditions: (1) Only costs incurred by the organization were included in its indirect cost pool as finally accepted; such costs are legal obligations of the organization and are allowable under the governing cost principles; (2) The same costs that have been treated as indirect costs are not claimed as direct costs; (3) Similar types of costs have been accorded consistent accounting treatment; and (4) The information provided by the organization which was used to establish the rates is not later found to be materially incomplete or inaccurate by the Federal Government or the Department. In such situations the rate(s) would be subject to renegotiation at the discretion of the Federal Government or the Department; (5) Prior actual costs used in the calculation of the approved rate are contained in the grantee's Single Audit, which was prepared in accordance with OMB Circular A-133. If a Single Audit is not required to be performed, then audited financial statements should be used to support the prior actual costs; and, (6) This rate is based on an estimate of the costs to be incurred during the period.

##### **B. Accounting Changes:**

This Agreement is based on the accounting system purported by the organization to be in effect during the Agreement period. Changes to the method of accounting for costs, which affect the amount of reimbursement resulting from the use of this Agreement, require prior approval of the authorized representative of the cognizant agency. Such changes include, but are not limited to, changes in the charging of a particular type of cost from indirect to direct. Failure to obtain approval may result in cost disallowances.

##### **C. Fixed Rate with Carry Forward:**

The fixed rate used in this Agreement is based on an estimate of the costs for the period covered by the rate. When the actual costs for this period are determined—either by the grantee's Single Audit or if a Single Audit is not required, then by the grantee's audit financial statements—any differences between the application of the fixed rate and actual costs will result in an over or under recovery of costs. The over or under recovery will be



carried forward, as an adjustment to the calculation of the indirect cost rate, to the second fiscal year subsequent to the fiscal year covered by this plan.

**D. Audit Adjustments:**

Immaterial adjustments resulting from the audit of information contained in this plan shall be compensated for in the subsequent indirect cost plan approved after the date of the audit adjustment. Material audit adjustments will require reimbursement from the grantee.

**E. Use by Other Federal Agencies:**

Authority to approve this agreement by the Department has been delegated by the Federal Highway Administration, California Division. The purpose of this approval is to permit subject local government to bill indirect costs to Title 23 funded projects administered by the Federal Department of Transportation (DOT). This approval does not apply to any grants, contracts, projects, or programs for which DOT is not the cognizant Federal agency.

The approval will also be used by the Department in State-only funded projects.

**F. Other:**

If any Federal contract, grant, or other agreement is reimbursing indirect costs by a means other than the approved rate(s) in this Agreement, the organization should (1) credit such costs to the affected programs, and (2) apply the approved rate(s) to the appropriate base to identify the proper amount of indirect costs allocable to these programs.

**G. Rate of Calculation:**

FY 2007-2008 Budgeted Indirect Costs	\$ 413,016
Carry Forward from FY 2005-2006	<u>-</u>
Estimated FY 2007-2008 Indirect Costs	\$ 413,016
FY 2007-2008 Budgeted Direct Salaries and Wages plus Fringe Benefits plus Unallowable Direct Salaries and Wages plus Fringe Benefits	\$ 830,935
FY 2007-2008 Indirect Cost Rate	49.70%

**CERTIFICATION OF INDIRECT COSTS**

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

- (1) All costs included in this proposal to establish billing or final indirect costs rates for fiscal year 2007-2008 (July 1, 2007 to June 30, 2008) are allowable in accordance with the requirements of the Federal and State award(s) to which they apply and OMB Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments." Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.

- (2) All costs included in this proposal are properly allocable to Federal and State awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government and the Department will be notified of any accounting changes that would affect the fixed rate.

I declare that the foregoing is true and correct.

Governmental Unit: Tulare County Association of Governments-

Signature: Ted Smalley

Signature: Ramón Lara

Reviewed, Approved and Submitted by:

Prepared by:

Name of Official: Ted Smalley

Name of Official: Ramón Lara

Title: Deputy Executive Director

Title: Regional Planner

Date of Execution: April 6, 2009

Telephone No.: (559) 733-6291

#### INDIRECT COST RATE APPROVAL

The Department has reviewed this indirect cost plan and hereby approves the plan.

MaryAnn Campbell-Smith  
Signature

Amada Maenpaa  
Signature

Reviewed and Approved by:

Reviewed and Approved by:

MaryAnn Campbell-Smith  
Name of Audit Manager

Amada Maenpaa  
Name of Auditor

Title: Chief, External Audit

Title: SMA

Date: 5/7/09

Date: 5/7/09

Phone Number: (916) 323-7105

Phone Number: (916) 323-7868

March 19, 2009

MaryAnn Campbell-Smith  
Chief, External Audits  
Audits & Investigations  
California Department of Transportation  
P.O. Box 942874  
Sacramento, CA 94274-0001

Dear Ms. Campbell-Smith:

The Tulare County Association of Governments (TCAG) has begun to implement the necessary actions outlined in the FY 2007/08 Initial Cost Allocation Plan (ICAP) Draft Audit Findings. TCAG has carefully reviewed the findings and will take the necessary actions recommended in the audit. TCAG agrees with the findings and appreciates the recommendations that have been provided. Below are the actions TCAG has taken and will take to correct the reported findings.

Finding 1 – In Fiscal Year 2006/07 TCAG did not have an ICAP and was not in the process of creating one, which led to the creation of Work Elements such as 601.02, where direct and indirect costs were aggregated. During this FY TCAG did not receive negative comments from Caltrans or FHWA/FTA regarding the agency not having an ICAP and TCAG's OWP was approved without an ICAP. In FY 2007/08, through the creation of TCAG's Overall Work Program (OWP), Work Elements such as 601.02 were revised into indirect costs work elements that only included indirect costs. For FY 2007/08 no expenses were billed for indirect costs until a provisional rate was given to TCAG. As continued guidance was given to TCAG for the FY 2008/09 OWP and ICAP, TCAG discontinued the use of all indirect cost work elements and instead began to allocate and bill for indirect costs through the use of an approved indirect cost rate (TCAG does not have an approved rate for FY 2008/09 and has not billed for any indirect costs to date).

Finding 2 – TCAG reassigned indirect labor and administrative costs for FY 2006/07 from one work element to others without the full supporting documentation of its accounting records. TCAG understands that a financial management system is required to provide accurate, current and complete disclosure of its financial activities. During the FY 2006/07 TCAG did not staff a full time accountant or fiscal staff, but has now hired a staff person that is adequately qualified to work on all of TCAG's fiscal duties. Financial activities are now properly managed and recorded by staff to allow for the proper reporting of TCAG's financial activities. In FY 2007/08 proper and adequate reports from TCAG's accounting systems were used for support of any expenses that were billed. Billings for FY 2007/08 were reviewed for inadequate charges of indirect costs and no unallowable charges were found. TCAG understands the need to adjust their FY 2007/08 billing due to the use of a provisional rate. This adjustment will occur when TCAG receives a final FY 2007/08 indirect cost rate.

Ms. Campbell-Smith  
March 19, 2009  
Page 2

Finding 3 - The use of a manual process to determine project costs and billings increases the risks of errors and requires the reconciliation between manual and automated processes. While TCAG does not currently have a fully automated system that facilitates financial reporting, an effort has been made to implement the County of Tulare's Windows-based AFIN system. TCAG also continues to use the County of Tulare's Resource Management Agency's (RMA) cost accounting system (WINCAMS). Both of these systems allow for better reporting options when compared to the manual system that was previously used by TCAG.

Finding 4 - Direct and indirect costs were not properly separated in their initial indirect cost allocation plan for FY 2007/08. TCAG believes that those issues have been resolved with better guidance from Audits and Investigations, and continuous work on the FY 2008/09 ICAP and FY 2009/10 ICAP.

Finding 5 - Indirect costs were initially presented in work elements 601.02, 601.04 and 601.07. TCAG has removed all three of those work elements from its OWP and expenses for those work elements are now being recovered under TCAG's indirect cost rate. For FY 2007/08, TCAG did not bill for any indirect costs directly through its billing and simply billed for indirect costs through its indirect cost rate.

Finding 6 - Unallowable costs were reported along with indirect and direct costs and were included in the initial indirect costs pool. TCAG has created work element 601.08 Government Relations to separate all unallowable costs from direct and indirect costs and unallowable costs are not calculated in the indirect cost rate.

The Tulare County Association of Governments understands the importance of the findings that were made during the FY 2007/08 ICAP audit and is fully committed to continuing to improve TCAG's OWP and ICAP.

If you have any questions please contact me at: (559) 733-6291 or by e-mail at [RXLara@co.tulare.ca.us](mailto:RXLara@co.tulare.ca.us)

Sincerely,



Ramon Lara  
TCAG Staff

cc: Ted Smalley, TCAG Executive Director